

## IMPACT OF BANKRUPTCY ON DOMESTIC RELATIONS CASES

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1. Bankruptcy -- Overview. A bankruptcy case begins with the filing of a “voluntary” petition by the debtor, or by an “involuntary” petition filed by creditors. On filing, the following significant events occur:
  - (a) A distinct legal entity – the bankruptcy estate – is created by law, to be administered under the protection and supervision of the Bankruptcy Court. It is an in rem proceeding. So, think of a bankruptcy case like a probate case.

Federal court (USDC) has exclusive jurisdiction of bankruptcy cases and over property of the estate. 11 U.S.C. § 1334. These cases (and proceedings arising in these cases) have been “referred” by a USDC standing order to the Bankruptcy Court; thus, the Bankruptcy Court exercises this exclusive jurisdiction over property of the estate, issues related to debtor’s discharge and certain other “core” matters. 28 U.S.C. §157.
  - (b) By operation of law, 11 U.S.C. § 362(a), an automatic stay becomes effective immediately to protect the debtor, the bankruptcy estate, and property of the bankruptcy estate from all litigation, debt collection, lien creation and lien enforcement.
  - (c) A procedure for relief from debts is begun under one of six operative “chapters” (e.g., Chapter 7, Chapter 11, Chapter 13).
  - (d) The date of filing defines the pre-petition and post-petition periods. Creditors have a deadline by which to file claims for pre-petition debts.
  - (e) For the benefit of creditors, the bankruptcy estate is vested with special rights and powers – (e.g., to compel third parties to turn over property of the estate, avoid certain pre-petition transactions, and cure defaults under leases and executory contracts).
2. The Bankruptcy Estate. The estate is protected by the power of federal court jurisdiction and by the automatic stay (injunction).

- (a) Chapter 7 (liquidation; administered by a “panel” trustee).
    - 1. The estate includes virtually all legal and equitable interests of the debtor in property on the petition date; but does not include post-petition earnings.
    - 2. The estate also includes certain assets acquired within 180 days after the petition: inheritances; property settlement distributions; and life insurance benefits.
  - (b) Chapter 11/Chapter 13. The “estate” includes all rights and interests of the debtor on petition date and post-petition earnings.
  - (c) In a case under any chapter, property of the estate falls into two categories:
    - 1. Property that is exempt under state law (or, where applicable, Federal law). See 11 U.S.C. § 522(b). In Florida, examples would be the debtor’s homestead (or \$4,000 “wild card” if no homestead), \$1,000 for a vehicle, \$1,000 for personal property, social security, 401k’s, IRA’s, tenancy by entireties property. Fla. Stat. § 222.01 *et seq.* (2008). Complex venue rule determines which state’s exemption laws apply. 11 U.S.C. § 522(b). Debtor has ability to avoid a judicial lien on exempt assets, like the homestead. 11 U.S.C. §§ 506(a), 506(d), and 522(f). The analysis of what is exempt can be complex. See e.g. Owen v. Owen, 500 U.S. 305, 111 S.Ct. 1833 (1991); Farrey v. Sanderfoot, 500 U.S. 291, 114 S.Ct. 1825 (1991).
    - 2. non-exempt property
3. Automatic Stay (11 U.S.C. § 362)
- (a) Operates as a statutory injunction (i.e., no proceeding or proof required) against a variety of acts, generally including (1) the commencement or continuation of actions against the debtor, or (2) acts that would affect property of the debtor or of the estate, but with certain exceptions.
  - (b) Any act done in violation of the automatic stay is void and the Bankruptcy Court may impose sanctions for violation of the stay.
  - (c) The Bankruptcy Court can grant relief from the stay, for cause.
  - (d) By statute, some actions are excepted from the automatic stay.

There are 28 exceptions enumerated in 11 U.S.C. § 362(b).

- (1) Section 362(b)(2) excepts from the stay the commencement or continuation of any proceeding - -
  - to establish paternity
  - to establish or modify an order for a DSO
  - concerning child custody or visitation
  - regarding domestic violence
  - for the dissolution of marriage *except to the extent that such proceeding seeks to determine the division of property that is property of the estate.*
- (2) This “exception to the exception” means that Bankruptcy Court approval is required before commencing or continuing any proceeding to divide property that is property of the bankruptcy estate.
- (3) What is property of the bankruptcy estate? It depends! Largely, it depends on (a) which state’s exemption law applies, (b) what the debtor’s interest in the property is (under state law), and (c) the extent to which the debtor is entitled, under applicable state or federal law, to claim such interest as exempt. The debtor’s claim of exemptions may be contested by creditors or by the trustee and litigated.
- (4) Trustee may abandon, from the estate, property that is of inconsequential value or is burdensome to administer.
- (5) Also excepted from the automatic stay, Section 362(b)(2)(B) – (G), are various actions for collection of Domestic Support Obligations. One of these is an exception from the stay for “collection of a domestic support obligation from property that is not property of the estate.” Section 362(b)(2)(B). Bankruptcy Court ruling may be required before taking unilateral action that would later be determined to be a stay violation.

4. General Rules:

- (a) The trustee and court will determine how “estate” property is to be administered and distributed. After the bankruptcy case is filed, the debtor is not free to sell or distribute estate property to the non-debtor spouse.

- (b) Deadline to object to debtor's claim of exemptions – 30 days after Section 341 creditors' meeting (11 U.S.C. § 341) is concluded.
- (c) Bankruptcy Court will adjudicate any objections to the debtor's claim of exemptions – homestead, tax refunds attributable to pre-petition period, TBE property (maybe there was a fraudulent transfer in creation of tenants by entireties).
- (d) Bottom line

Whether the exceptions in Section 362(b)(2) apply depends on whether the affected asset is property of the estate, which may require Bankruptcy Court ruling.

## 5. Discharge

In 2005, the Bankruptcy Code amendments ("BAPCPA") added a new defined term – Domestic Support Obligation ("DSO"). 11 U.S.C. § 101(14A).

DSO is a debt that accrues before, on, or after the commencement of the case . . . that is

- (a) owed to a spouse, former spouse, child, child's guardian, or governmental unit;
- (b) in the nature of alimony, maintenance or support – without regard to whether the debt is so designated;
- (c) established by divorce, separation or property settlement agreement, or by court order, or by governmental unit determination; and
- (d) is not assigned to a non-governmental entity (except voluntary assignment by former spouse, etc., for collection purposes).

DSOs are not dischargeable in bankruptcy – period!

- (a) Section 523(a) - - certain debts are excepted from discharge. These debts cannot be discharged in bankruptcy.
- (b) § 523(a) --
  - (5) debt for a Domestic Support Obligation ("DSO") ( which is

defined in 11 U.S.C. § 101(14A), generally as debts  
-- owed to spouse, former spouse, or child  
-- in the nature of alimony, maintenance or support  
-- functional test, regardless of what terms are used.  
See *Cummings v. Cummings*, 244 F.3d 1263  
(11<sup>th</sup> Cir. 2001) (functional test applies, because there is  
often overlap between property distribution and support).

(15) divorce debts that are not DSO's (e.g., division of family business value; agreement to pay debts; "lump sum alimony" payable as property settlement; husband's obligation to pay ex wife one-half of pension check that he receives).

(c) Under pre-2005 law, the debtor could discharge non-DSO type obligations if: (1) no one filed a lawsuit challenging the dischargeability within 60 days after the meeting of creditors was concluded; or (2) if Bankruptcy Court determined that the debtor did not have the ability to pay or the benefit of the discharge outweighs detriment to the non-debtor spouse.

This created a trap for the unwary and for the under-financed non-debtor spouse. BAPCPA changed the law.

(d) Why then, are there still two categories of divorce debt?

-- Chapter 7 – no difference in treatment of DSO's and non-DSO divorce debt. Neither is dischargeable!

-- Chapter 11 – no difference. Neither is dischargeable!

-- But, in a Chapter 13 case – only DSO's are excepted from discharge. 11 U.S.C. § 1328(a). Non-DSO divorce debts (functional test) are dischargeable if the debtor spouse completes the Chapter 13 plan or satisfies requirements for a hardship discharge. 11 U.S.C. § 1328(a) and (b).

(e) State courts have concurrent jurisdiction to determine whether a debt has been discharged in bankruptcy.

## 6. Domestic Support Obligations - Summary

Obligations in the nature of alimony, maintenance, or support are given priority and special treatment and are excepted from the bankruptcy discharge.

- 11 U.S.C. § 101(14A) defines “domestic support obligation” (DSO) as is a debt that accrues before, on or after the filing of a bankruptcy petition, including interest, established or subject to establishment before, on , or after the filing of a bankruptcy petition, owed to a spouse, former spouse, or child, **in the nature of alimony, maintenance, or support** without regard to whether such debt is expressly so designated.
- Priority: Section 507(a)(1) – a DSO is a first priority debt.
- Exception from the automatic stay: Section 362(b)(2) – establishing a DSO is excepted. But watch out for the exception to the exception!
- Exception from discharge: Section 523(a)(5) – a DSO is not dischargeable. (In Chapter 13, non-DSO divorce debts may be dischargeable).
- Duties of Chapter 7 trustees: Section 704(a)(10) and (c) – the Chapter 7 trustee must provide notice to holders of claims for DSOs and to state child support enforcement authorities.
- Chapter 11 cases: Section 1129 – an individual Chapter 11 plan cannot be confirmed unless all post-petition DSOs are current.
- Duties of Chapter 13 trustees: Section 1302(b)(6) and (d) – Chapter 13 trustees have notice obligations similar to the Chapter 7 trustees’ obligations.
- Chapter 13 dismissal or conversion: Section 1307 – failure to pay a DSO that accrues post-petition is cause for dismissal or conversion of a Chapter 13 case.
- Chapter 13 Plan: Section 1322 – a Chapter 13 plan that pays less than the full amount of DSOs must provide that all projected disposable income of the debtor be paid for 5 years.
- Chapter 13 confirmation: Section 1325 – post-petition DSOs must be current for a plan to be confirmed.